

Cornerstone Commentary

Highlights



When the Facts Don't Fit the Story... Change The Facts

How Wall Street's Marketing Machine missed the point of International Investing

By John Riley
 Chief Strategist

We've all seen the pie charts below that show how US economic domination has been dwindling for decades. This is many times given as the main reason for investing overseas.

The implication is that as the world economy is growing, the US share of the global economy is shrinking. This is many times the excuse given by pundits for our growing Trade Deficit and declining Dollar.

You will notice however, that this type of chart is almost always (as far as I've ever seen) 2 or 3 pie charts with different dates on them, usually decades apart. You, as the reader, are expected to fill in the blanks and mentally connect dots between the pie charts with a straight line.

But selecting data points from a series of data can be misleading. What exactly do the points in between the pie charts do? Are they a straight line as the marketing pieces would imply?

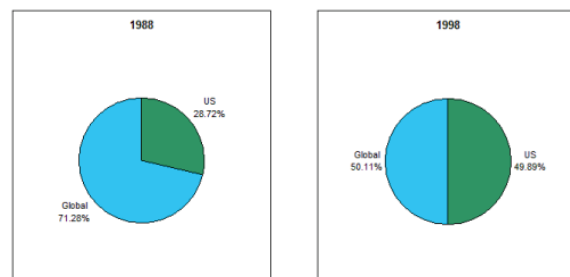
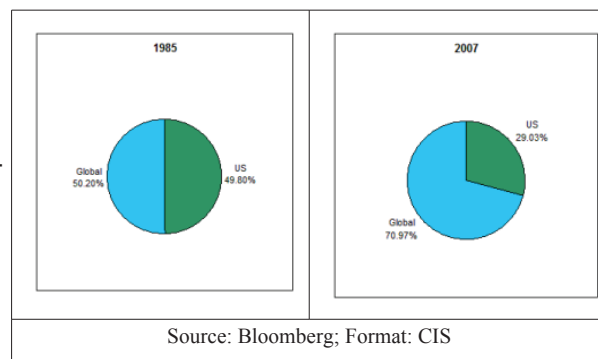
For instance, in 1998, you might have been able to read a headline like this: "US Doubles its share of Global markets" and seen pie charts like these:

What?!? The first set of charts above showed the US markets losing ground to foreign competition, but these charts above are showing the US doubling its market share of the global markets. Which is right?

Both. Both sets of pie charts are accurate. The story told along with them in some marketing pieces may not be.

The charts represent 2 things: First, each pie chart is the percentage of something at a specific point in time. Second, the "something" is equity market capitalization. Equity market capitalization is nothing more than the value of the stock market, how much all of the stocks added together are worth. The comparisons are between the Global stock markets and the US stock markets.

The charts tell you nothing about trends and they tell you nothing about economic activity. Any implication to the contrary is misleading.



As Seen in

Forbes

Cornerstone

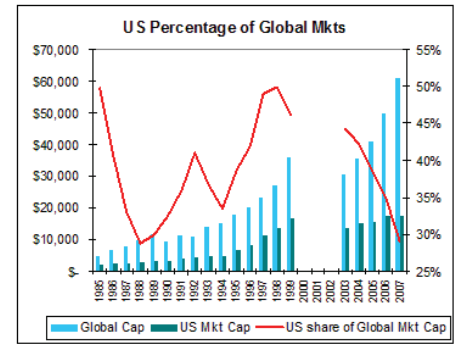
Investment Services has been chosen by Goldline Research as one of the **Ten Most Dependable Wealth Managers of the NorthEast**

Below is the chart with the data points in between the pie charts filled in:

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The first thing you should notice is that 2000, 2001 and 2002 are missing. Bloomberg had no reason why they were missing from their files. It could be as simple as they stopped monitoring the numbers during those years.

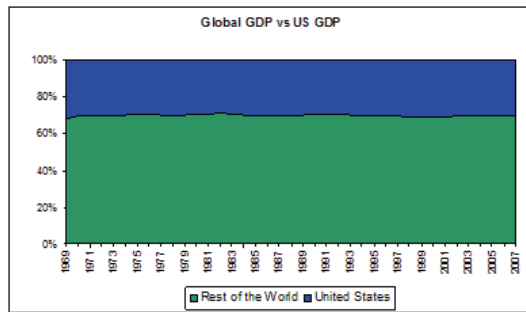
The second thing you should notice is that the US share of Global Market Capitalization has been cyclical for the past 20+ years. There were times it declined and times it rose. To say that the general trend has been down over the past 23 years would not be true. It has been down over the past 9 or 10 years, but it is only about as low as the 1988 low, 20 years ago.



Source: Bloomberg; Format CIS

What does this mean for the US economy? Does market capitalization have anything to do with economic activity? We have all seen great strides in the growth of certain foreign economies. Surely the US share of the Global economy has been declining for decades, hasn't it?

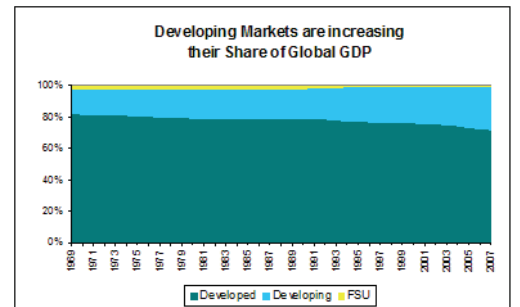
The answer is a very simple no. In fact, the US share of the Global GDP (Economy) has barely budged. From 1969 through 2007, the US share of Global GDP has hovered around 30%, plus or minus a point.



Source: USDA; Format: CIS

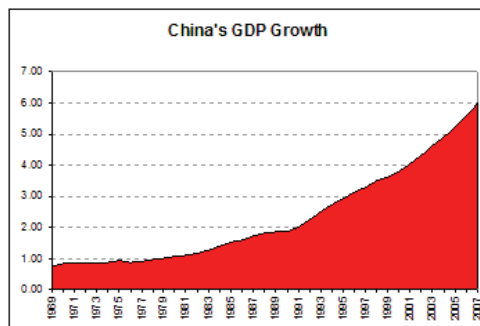
But it doesn't end here. We continued to dig into the numbers and found something that had been believed for some time. The share of Global economic activity was shifting, from Developed countries to Developing countries.

Since 1969, Developing Countries have almost doubled their share of the Global GDP from 15.64% to 27.27%. If you are looking for economic growth, look to the Developing countries.



Source: USDA; Format: CIS

A good example of this growth in Developing Markets is China. Its share of Global GDP has risen from less than 1% to almost 6.00% since 1969.



Source: USDA; Format: CIS
market share according to USDA data.

This is not a recommendation to go out and buy a China fund. It is a review of where some of the strongest economic growth has been coming from over the past few decades.

Developing countries have been taking market share away from Developed Countries. But from whom? The FSU (Former Soviet Union) has lost almost half of its share of Global GDP since 1969. Also since 1969, Europe has also lost 24% of its

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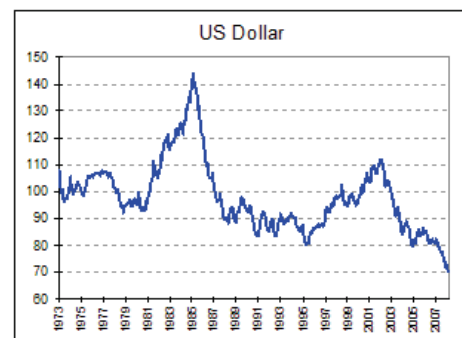
So is the point of the marketing, that international investing is important, correct? Surprisingly, the answer is yes. But not for the reasons the famous Pie Charts would imply.

What this means to investors?

Since the US has been playing on a level playing field with the rest of the world and not having its share of Global GDP eroded by growing foreign economies, our own data takes on new implications. No longer can we blame foreigners for our international trade problems.

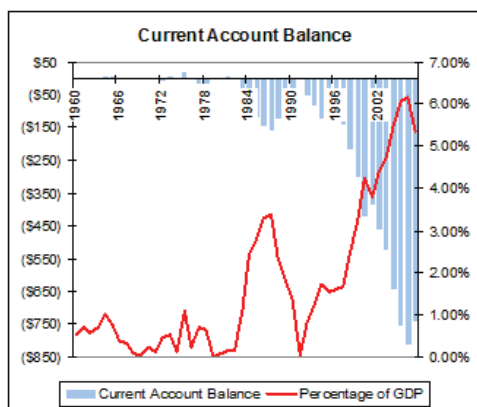
In the US, we've been talking about "Globalization" for about a decade or so. What does it mean? What has it done for our economy? Has it improved our share of Global GDP? Has it made our economy stronger? Has our trade deficit declined? Has our Dollar strengthened? No is the answer to all these questions.

Since 1985, when the G5 collaborated on a reversal of the US Dollar's strength, the Dollar has lost about 50% of its value. Since 2001, it has lost about 36% of its value. Many experts (including the Administration) have believed that the Dollar's decline would be a cure for our rising Trade Deficit and Current Account Deficit.



Source: Fed Res; Format: CIS

Yes, exports have gone up, but imports continue to grow faster than exports and our Current Account Balance (Deficit) continues to get worse. This means that while our share of total Global economic activity has been stagnant for decades, we continue to owe our trading partners overseas more and more money.



Source: Fed Res; Format: CIS

Looking only at Federal Government debt and stripping out that owned by Agencies, Trusts and Federal Reserve Banks, we owe about 45% of all Federal debt to foreign investors. In the early 1980's it was only about 15%.

Avoiding likewise the accumulation of debt
– **George Washington**

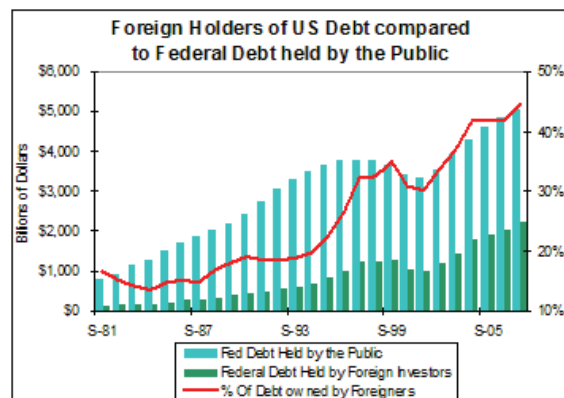
Live within your means, never be in debt, and by husbanding your money you can always lay it out well. But when you get in debt you become a slave. Therefore I say to you never involve yourself in debt, and become no man's surety. – **Andrew Jackson**

Rather go to bed supperless than rise in debt. – **Benjamin Franklin**

Apparently, we have forgotten what our fore-fathers taught us.

Our Current Account Deficit has grown to over 5% of our GDP. That means we owe 5% of our GDP to Foreigners.

Worse than that, since 1981, the US has needed to borrow more and more money from overseas investors to finance our economic growth.



Source: Fed Res; Format: CIS

Highlights

Runs on Banks
Brokerage Failure(s)
Mortgage Giants Fail
Derivative Calamity
A Banking Holiday

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Wrap-up

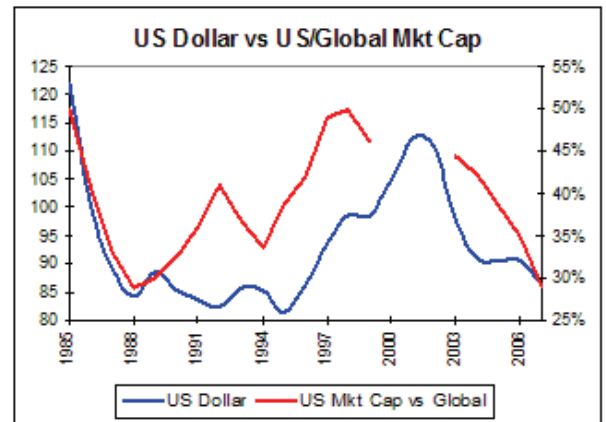
What does this mean to investors? Our analysis shows that because of the huge run-up in debt, the amount of foreign debt ownership and the declining Dollar, the US is not the best place to invest in the World. The Wall Street Marketing Machine got it right, albeit with spurious data. Given the choice of equity markets, the international markets, especially the Developing markets look like the better choice.

But our analysis goes further. The chart above that showed what our US Equity Market Cap really looked like on a linear chart struck me. It looked like another chart I was familiar with. And then it hit me.

It appears that the change in percentage of the US Market Capitalization compared to Global Capitalization has less to do with economic activity (GDP) and more to do with the Dollar.

As the Dollar goes, so goes the share of the US Equity percentage in the Global Market Cap. For years I have been telling investors that the Dollar would likely be the catalyst for any major declines in the market and economy. It appears that the Dollar is linked much more closely to the US market than was previously believed.

If you are of the opinion that the Dollar is likely to fall further, which we are, then you would also have to consider the possibility of the US Market Cap to decline relative to the Global Market Cap. So foreign markets would be a better place for investment, not because of their stronger economies, but as a hedge on the falling Dollar. (And if you are looking for where the economies are really growing, you look to the Developing Markets)



Source: Bloomberg; Federal Reserve; Format: CIS

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